Where is Illinois Headed?

IGPA’s Fiscal Futures Project

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I. The Why

• Illinois lacks sufficient capacity to project fiscal demands & revenue streams into future
  – But many current choices have multi-year impact
  – Like the effects on future budgets of
    • Borrowing against or obligating future tax revenues
    • Delaying payment for current obligations
    • Not funding pension liabilities

• Lack of transparency in budget information

• Threatening demographic & health-cost trends
  – More retirees and fewer worker-taxpayers
  – Increasing share of state budget to medical costs
II. The How

• Compile state budget data into meaningful and consistently measured categories
• Estimate relationship between budget components and “driver” variables
• Use projections of driver variables to project receipts and spending into future
III. Creates Improved Budget Measure: “Consolidated” not “General Funds” Budget

• More inclusive
  – Covers 380 v. 4 funds
  – Covers $61 billion v. $35 billion of spending in FY09

• More transparent
  – Brings major categories of state spending, like transportation, into the analysis
  – Inter-fund transfers don’t obscure analysis
  – Re-assigning items won’t obscure analysis
With consolidated funds have a consistent view of past budgets

• Budget gap = Receipts – Expenditures called “Surplus” if (+) or “Deficit” if (−)

• Budget gap under alternative measures
  – (A) Existing practice, which counts new borrowing as a receipt
  – (B) 1st alternative excludes new borrowing
  – (C) 2nd excludes borrowing and adjusts for cost of new unfunded pension liability
Figure 1: Surplus (+) or Deficit (-) in consolidated Illinois budget under alternative definitions

Source: Revised Table A.4.1
This look at 2000-09 budget gaps shows:

• Modest deficits or surpluses if (A) count borrowing and ignore new pension liability (exception: pension bonds sold in 2003, spent in 2004)
• Larger deficits and only one tiny surplus if (B) don’t count borrowing as a receipt
• Large deficits in each of last 9 years if (C) also adjust for unfunded pension liability (but in 2000 was a tiny surplus, because stock market gains offset failure to fully fund new pension liabilities)
IV. Using model for budget projections

- Start with consolidated data for separate budget categories
- Supplement with data on economic and demographic “driver” variables
- Estimate relationship between budget components and driver variables
- Use projections of driver variables to project receipts and spending into future
Table 1: Expenditure Categories—Amounts and Projection Module Specification

<table>
<thead>
<tr>
<th></th>
<th>$ Bil. FY’09</th>
<th>Predictors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medicaid</td>
<td>14.1</td>
<td>growth in personal income</td>
</tr>
<tr>
<td>Elementary/Secondary Education</td>
<td>9.4</td>
<td>growth in personal income &amp; growth in population age 5-17</td>
</tr>
<tr>
<td>Human Services</td>
<td>9.0</td>
<td>growth in personal income</td>
</tr>
<tr>
<td>Transfer Revenue to Local Govts</td>
<td>5.4</td>
<td>same as “parent” revenue categories</td>
</tr>
<tr>
<td>Transportation inc. Tollway</td>
<td>4.6</td>
<td>growth in consumption of autos</td>
</tr>
<tr>
<td>Debt Service</td>
<td>3.4</td>
<td>as scheduled</td>
</tr>
<tr>
<td>Pensions</td>
<td>2.5</td>
<td>as scheduled</td>
</tr>
<tr>
<td>Higher Education</td>
<td>2.4</td>
<td>growth in population age 18-24</td>
</tr>
<tr>
<td>All Other Combined</td>
<td>10.2</td>
<td></td>
</tr>
<tr>
<td>Total Expenditures</td>
<td>61.1</td>
<td></td>
</tr>
</tbody>
</table>
Table 2: Receipts Categories—Amounts and Projection Module Specification

<table>
<thead>
<tr>
<th>Category</th>
<th>$ Bil. FY’09</th>
<th>Predictors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Funds</td>
<td>16.4</td>
<td>growth in population</td>
</tr>
<tr>
<td>Personal Income Tax *</td>
<td>9.2</td>
<td>Construct “anticipated revenue,” given the tax rate, after personal exemptions, &amp; after tax credits. Relate what’s left to growth in personal income.</td>
</tr>
<tr>
<td>General Sales Tax *</td>
<td>9.0</td>
<td>growth in consumption net of services</td>
</tr>
<tr>
<td>Bond Issue Proceeds</td>
<td>3.3</td>
<td>assumed zero</td>
</tr>
<tr>
<td>Business Income Tax *</td>
<td>2.8</td>
<td>growth in personal income &amp; growth in employment</td>
</tr>
<tr>
<td>Motor Fuel/Vehicle/Operator *</td>
<td>3.0</td>
<td>set to fixed amount in nominal dollars</td>
</tr>
<tr>
<td>Short-Term Borrowing</td>
<td>2.4</td>
<td>assumed zero</td>
</tr>
<tr>
<td>Public Utility Tax *</td>
<td>2.0</td>
<td>growth in personal income</td>
</tr>
<tr>
<td>Smaller Categories Combined</td>
<td>10.3</td>
<td></td>
</tr>
<tr>
<td><strong>Total Receipts</strong></td>
<td><strong>58.6</strong></td>
<td></td>
</tr>
</tbody>
</table>

*Includes local govt. share
Figure 2: Projected Growth for Consolidated Expenditure Categories
(annual average percentage rate for 2010 to 2024)

- Medicaid: 7.2%
- Elementary/Secondary Ed.: 4.9%
- Human Services: 3.4%
- Transfer Rev. to Local Govts: 1.9%
- Transportation inc. Tollway: 4.6%
- Debt Service*: 4.7%
- Pensions: 4.7%
- Higher Education: 0.4%
- All Other Combined: 2.9%
- Total Expenditures: 4.6%

* Model assumes no new debt and only debt service currently obligated.
Figure 3: Projected Growth for Consolidated Receipt Categories
(annual average percentage rate for 2010 to 2024)

* Model assumes no new debt and only debt service currently obligated.
Budget projection results

• Expenditures
  – High projected growth for Medicaid, K12 education, transportation, and pension obligations
  – Total outflow projected to grow 4.6 % per year

• Receipts
  – Very low sales tax growth; modest income tax growth; federal aid (based on past experience) projected to be high growth
  – Total inflow projected to grow 3.5 % per year

• Projections by year (next slide)
Figure 4: Actual (FY 1997-2009) and Projected (FY 2014-2030) Illinois Consolidated Total Receipts and Expenditures with new borrowing not counted as a receipt (gap definition “B”).
Model projects growing deficits

- This is because spending is projected to grow faster than receipts
  - Seemingly small 1 % per year difference, but
  - Difference compounds each year resulting in growing gap—a “structural deficit”

- Model makes “trend projections” not predictions of what will actually happen
  - Policymakers will be forced to decrease spending, increase taxes, or both
V. Using the model for “Scorekeeping”

• The model can simulate future budgets under alternative policy scenarios

• We’ve done initial simulations of increases in some major taxes. The bottom line:
  – There is no perceptible impact on growth rate of revenue in future, so
  – Even if tax change closes budget gap in one year, the deficit will reemerge in near future

• Can simulate different assumptions about economic or demographic trends
VI. The So What: Could change policy discussion

- Having projections will encourage explicit discussion of long- and short-run tradeoffs
- With projections, policymakers and media can better understand which policy elements merit the most attention
  - reducing the chance that the discussion gets sidetracked on less essential points
VII. Recent extensions of the model

• Separate capital spending from rest
  – Transportation, Natural Resources, Economic Development, and Capital Improvements
  – Link to specific revenues?
  – “Grants” for non-state capital projects

• Gov. Quinn’s Mar. 2010 proposal for FY11
  – Final budget adopted won’t be same, but
  – is more current baseline, especially revenues
  – Had to construct “consolidated” version
Figure 5: Budget Gap with Alternative Baselines (all with new borrowing not counted as receipt—gap def. “B”)

Source: Revised Table A.4.1 in May report (see notes to table)
VII. Summary Points

- Consolidated budget is more transparent
- Model can project current policy to future
- Model can estimate future budgetary impact of alternative policies

- Fiscal Futures Model is still a work in progress and we are seeking funding to continue
For reports or to contact us:

- Full report and other materials downloadable from [http://igpa.uillinois.edu/content/fiscal-futures-project](http://igpa.uillinois.edu/content/fiscal-futures-project)
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